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Ten-shun! Welcome to Social Security boot camp

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The following is an edited transcript of a webcast, "Social Security Boot Camp: Claiming Strategies," held Aug. 20 and moderated by InvestmentNews *deputy editor Greg Crawford.*

InvestmentNews: Our guest for today's webcast is retirement expert and contributing editor for *InvestmentNews* Mary Beth Franklin. Specifically, she will cover today why 66 is the magic age to collect Social Security benefits, claiming strategies for married couples, when it is appropriate to use file and suspend, restricted claims for spousal benefits only and dependent benefits for minor children.

Mary Beth, could you give us an overview so that we know what we're going to be discussing today?

Ms. Franklin: Absolutely. We're here to talk about a crucial issue in retirement planning: Social Security-claiming strategies.

Knowing when and how to claim Social Security benefits is so important because it can boost retirement income by tens of thousands of dollars for an individual over their lifetime. And for married couples, who really have the most flexibility in coordinating their claiming strategies, it can mean $100,000 or more lifetime income over their joint lives.

First of all, your age matters when it comes to Social Security benefits. Anyone can collect benefits as early as 62, but those benefits will be reduced for the rest of their lives. It doesn't bump up once you hit full retirement age.

Right now, for people whose full retirement age is 66 (those born between 1943 and 1954), if you claim at 62, you're going to take a 25% haircut for the rest of your life. You can see that that gradually increases for birth years of 1955 and afterwards. And for anyone born in 1960 or later, their full retirement age is 67. And the reduction they get in benefits at 62 is 30%.

If you wait until your normal retirement age, you can collect your full retirement benefit, even if you continue to work. Or if you choose to delay to the latest point, which is 70, you will get an increase in your basic benefit worth 8% per year between your full retirement age and 70.

Now, many of you who read my columns and blogs know that I always say 66 is the “magic” age. If you remember nothing else from this webcast, I want you to remember 66 is the magic age, for three reasons.

One, it's the age when you can collect your full benefit. Two, it's the minimum age for you to engage in some of these creative claiming strategies we're going to be discussing. And three, you can collect benefits and continue to work without losing any money to the earnings cap.

Now, let's talk about what that earnings cap is and what it means. If you collect benefits before your full retirement age and continue to work, and you earn over a certain limit, you're going to start giving benefits back. For those who are under full retirement age for the entire year, that limit this year is $15,120. If you have earnings — and this means earnings from a job, not investment earnings or pension, etc. — and you earn more than $15,120, you are going to lose a dollar in benefits for every $2 you earn over that limit.

There's a more generous earnings limit in the year you actually reach your full retirement age. If you turn 66 at any point in 2013, you can earn up to $40,080 in the months prior to the month you turn 66. If you earn more than that, then you'll lose a dollar in benefits for every $3 over that more generous limit.

You can see where, with the earnings cap, the benefits are not really gone forever; they're merely deferred. But I like to say Lesson No. 1 here is that if you plan to keep working, in most cases, it makes no sense to claim reduced retirement benefits early, because you're going to forfeit the benefits, and more importantly, you're going to forfeit your chance to engage in some of these creative claiming strategies.

There are exceptions to every rule. Some people should collect Social Security benefits as early as they can, particularly if they need the money. Face it — you probably have a lot of clients who thought they were going to work until 66 and then lost their job at 59 or 60 or 61, and their finances have changed. If they need the money, they should take the benefit. That's what it's there for, particularly if they are no longer working or at least not earning much above the earnings cap, or if they're in poor health and they may not live till their normal life expectancy. Because all these benefits are actuarially even. Social Security says that if you collect early reduced benefits at 62, or wait until your normal retirement age and collect a full benefit, or wait even up until 70 for the maximum benefit, things are going to even out over your lifetime. You basically will get a smaller benefit upfront for a longer period of time or a bigger benefit for fewer months.

But if you're from a family with a long life expectancy and you're in good health, the longer you live, the longer you're going to benefit from delaying your benefits and getting the maximum amount.

Now, when it comes to single individuals, they don't have complicated claiming strategies. They're pretty much looking at what their health is and whether they're going to live a long time. If so, they may want to delay benefits. What are my finances? Can I afford to delay benefits? And am I going to keep working? As I said, if you plan to keep working, generally, it does not make sense to claim reduced benefits early, because of the earnings cap.

But if you have clients who say they're single, you have to ask: Are they really single, or are they single because they are divorced, or single because they're widowed? In those situations, those “single” people who are divorced or widowed really may have many more claiming strategies.

For the moment, let's turn to married couples. They have so many more options. And sometimes it does make sense for one spouse, the lower earner, to collect early. Now, I do want to jump in here and say because of the Supreme Court decision to strike down the Defense of Marriage Act ruling on same-sex marriage, now legally married same-sex couples — and this is important — who reside in a state where their marriage is recognized now have all of the same rights as any other married couple.

Let's move on to coordinating benefits for married couples. In most cases, it makes sense for the higher-earning spouse to delay benefits as long as possible, up until 70. And there's two reasons for that. Not only is that spouse locking in the maximum retirement benefit for him or her, but it's likely going to lock in the largest survivor benefit. And Social Security benefits are gender-neutral. It really doesn't matter whether it's the man or the woman who is the bigger earner.

As I mentioned earlier, sometimes the lower-earning spouse may want to claim reduced benefits early at 62. Now, that assumes — and I'm going to say she, I'll be sexist here — let's assume that she is no longer working or not earning much above the earnings cap. And the reason this makes sense is because, yes, she may have a reduced benefit, but actuarially, it's likely that her husband will die first. And if he is the larger earner and he delays his benefit as long as possible, he'll have the biggest retirement benefit for him, and when he dies, she will step up to that larger survivor benefit.

So it does make sense to have some money come in early and then a bigger benefit come in later. Even though the higher earner may want to delay benefits as long as possible, and the lower earner might want to take benefits as soon as possible, there's room for a little bit of magic in between.

One of the key things you have to remember about Social Security benefits is that a spousal benefit is worth 50% of the worker's benefit if it's collected at full retirement age. It can be collected earlier, as early as 62, but it will be reduced. Most importantly, survivor benefits are worth 100% of what the worker received or was entitled to receive at time of death. Again, if it's collected at full retirement age; less if it is collected earlier.

Survivors can collect two years earlier. Survivors can collect benefits as early as 60. So I'm going to throw another math equation at you. Often you're going to have clients, married couples, where the lower earner — and again, I'm going to say the wife in this case — has her own retirement benefits based on her own earning record and is also entitled to benefits as a spouse. And in many cases, that spousal benefit is going to be bigger.

Now we're going to talk strategies.

There are basically two magic strategies to boost benefits. The first one is file and suspend. And what that means is, the worker — if he is at least full retirement age, in this case 66 — says to Social Security, “I want to file for the purpose of triggering my spouse's benefits, but I want to delay collecting my own.”

The other option, again, if you wait until the full retirement age of 66, is to restrict a claim to spousal benefits only. What this assumes is that one spouse is already collecting. The other one is at least normal retirement age or full retirement age and has not yet claimed. But he can say at 66, “I want to restrict my claim to spousal benefits only.” That means, “Give me half of what she's getting; let my own benefit continue to grow.”

In this case, let's say the wife is collecting $1,000 a month. If that's her benefit at full retirement age and the husband restricts his claim to spousal benefits only, he will get $500 a month for the next four years. And then at 70, he can switch to his maximum benefit — which takes into account the delayed-retirement credit worth 8% per year for each year he postpones benefits between his full retirement age and 70. So in that example, if he waited until 70, his benefit would be worth 132% of his full retirement age benefit. And it would actually be worth even more than that because he would also get the cost-of-living adjustments for those four intervening years.

For whom do the magic strategies — filing and suspending, or restricting a claim to spousal benefits only — work? I'm going to give you examples of three different kinds of couples.

First, let's assume a traditional couple where one spouse — and again, I'm being sexist here — let's say the woman has little retirement earnings credits, or none, for that matter. In this case, her only benefit in some cases is going to be a spousal benefit. But she can't get a spousal benefit until her husband worker either claims a benefit or he files and suspends. So for this traditional couple, it may make sense for him at full retirement age to file and suspend in order to trigger benefits for his wife.

Most of your clients are going to fall into the category now where both spouses have at least some earnings record, some retirement benefits on their own earnings record.

In this case, one spouse files early. And the other one, if he or she waits till 66, that's when they can restrict the claim to spousal benefits only. “Give me half of what my spouse is getting; let my own benefits keep growing.”

My final case study of what I like to call the power couples involves the professional couples where each spouse may have maximum earnings. This case assumes they are close in age. Let's say both spouses are 66. You can exercise a combo strategy, and this is really valuable where one spouse at 66 says, “I want to file and suspend to trigger benefits for my spouse.” Then the second spouse, who is also at least 66, says, “But don't give me my whole benefit. I want to restrict my claim to spousal benefits only. Give me half of what my spouse is entitled to.”

And then at 70, they can both switch to their maximum benefits. And I'm going to put some numbers here so you get an idea of how powerful this strategy is. Let's say both spouses are entitled to $2,000 per month at their full retirement age of 66. Under this combo strategy, the husband says, “I want to file and suspend.” That means he gets nothing for the next four years. Then the wife, who is also 66, says, “I want to restrict my claim to spousal benefits only.” That means she would get half of his benefits, $1,000 a month. That's $12,000 a year for each of the next four years.

Now, at 70, they are both going to claim their maximum benefits. Under this scenario, each of their benefits, instead of being worth $2,000 a month, will be worth $2,640 a month, plus inflation adjustments. But under that scenario, you're talking $250 per month, times two, times 12 months. That is more than $63,000 a year in guaranteed cost-of-living-adjusted benefits. And what is so important about that is, many of your clients are not going to have any other sources of income that, one, is guaranteed, and two, is cost-of-living-adjusted. And frankly, your college-educated white-collar clients are the ones who are likely to live into their 80s and 90s.

At about a 3% rate of inflation, this is going to double in 25 years. And that's when you're really going to need the money. So the bigger your base benefit is, the bigger the annual cost-of-living adjustments will be going forward.

Again, if you remember nothing else, think of Lesson No. 2 — that for most married couples, creating the largest possible benefit for the surviving spouse should be the main goal. And as you've gotten a sense from this so far, it makes sense sometimes for that lower-earning spouse to claim reduced retirement benefits because — and this is what a lot of people don't understand — even though her retirement benefits will be permanently reduced, it will not affect her survivor benefits. She will get 100% of the survivor benefits, unreduced, if she is at least full retirement age at the time.

Greg, you had asked me earlier what were some of the most common questions I get?

This is it right here: what couples can't do. While you seem to understand that 66 is the magic age to file and suspend or to file a restricted claim for spousal benefits only, couples can't both file and suspend. Or they can't both file a restricted claim for spousal benefits only. I did a video for INTV on this a while ago, and I said it's like watching a couple walk down the New Jersey boardwalk where they both a wear a T-shirt that says, “I'm with stupid,” pointing to each other. They cancel each other out.

If one of you files and suspends, which means, “Don't give me a benefit; I want mine to grow,” and the other person said, “I want to file and suspend,” nobody would get anything, so that doesn't make sense. Similarly, if you say, “I want to file a restricted claim for spousal benefits only,” someone has had to claim benefits first in order for you to restrict your claim to spousal benefits only.

But under the combo strategy we just discussed, assuming you are both at least 66, one of you can file and suspend to trigger benefits for the other. And the other one, who is also at least full retirement age, can file a restricted claim for spousal benefits only. And then at 70, you can both switch to the maximum benefits.

Now, we keep talking about these delayed-retirement benefits. This is what I think has really been the game changer for why financial advisers and their clients care so much about Social Security-claiming strategies. It's the fact that for every year you delay between your full retirement age and 70, you get an increase of 8% per year based on your primary insurance amount at full retirement age.

Even a decade ago, it was most common for people to claim benefits at 62. The theory was, “It's my money; I'm grabbing it while I can. Who knows if it's going to be there? And besides, I can just invest it and make more money.”

Ten years ago, you might have been able to get double-digit returns on a fairly safe investment. I don't have to tell any financial adviser out there that those days are history, for the moment. So if you can find another risk-free return of 8% a year, good luck. Otherwise, delay benefits, assuming that your client is healthy enough that they're going to be there to collect it. I like to say it's a bit like the lottery; you must be present to win. It doesn't make sense to delay if you are unlikely to live long enough to reap the rewards.

Of these delayed-retirement credits, there's a lot of misunderstanding, and a lot of the questions I get reflect this. Who benefits from these delayed-retirement credits? It is only the worker that gets the extra 8% per year between full retirement age and 70. In other words, the spousal benefit is not going to increase when the worker claims the bigger benefit at 70.

The spousal benefit is based on half of the primary insurance amount. Half of the full retirement age benefit. So some people would say, “Well, if the spousal benefit is not going to increase along with the delayed-retirement credits, why should I bother waiting?” It's because of what it does to the survivor benefit. Remember, I said that a survivor benefit is worth 100% of what the worker received or was entitled to receive if he died before claiming. And that includes the delayed-retirement credits. So for a married couple, if the bigger earner can possibly afford to delay and is healthy enough to delay, it is a great way to lock in the maximum benefit during the couple's lifetime and for the survivor's lifetime.

I've been saying that actuarially, the husband is likely to die first, but you know, that doesn't always happen. Let's say the wife — the lower-earning spouse — dies first. In this case, the surviving husband who is the bigger earner and has the bigger benefit, his benefit isn't going to get any bigger. He's going to keep that same maximum benefit. And the smaller benefit is going to disappear.

But for so many women, who are likely to live decades in retirement, and many of those years without the spouse, planning for the biggest survivor benefit possible is really important. Speaking of survivors, I want you to think of survivor benefits and retirement benefits as two separate pots of money. As I mentioned, you can take a retirement benefit, even if it's reduced, and if you later become a widow or a widower, you are going to step up to this bigger survivor benefit if the other spouse's benefit is bigger. And even though you took your own retirement benefits early at a reduced rate, if you are at least full retirement age at the time, that survivor benefit is going to be 100% of what the deceased worker got.

Not only do you have this benefit if you can step up to a bigger survivor benefit, you can also choose when to collect the survivor benefits. And this is where financial advisers become very important to their clients, because it's not always intuitive. A widow or widower can collect benefits as early as 60. But they are going to be reduced compared to what they would be at full retirement age. And anyone who collects any kind of Social Security benefit before their full retirement age is subject to that earnings cap we discussed earlier. So let's say you have a young widow who is 60. Yes, she could collect a reduced survivor benefit, but if she's working full time, it might not make sense.

If she waits till her full retirement age, let's say that's 66, she could collect survivor benefits worth 100% of her deceased husband's benefit, and she could continue to work if she likes, because at that point, the earnings cap disappears. Now, here's where the strategy comes in. Survivor benefits are frozen in time. Yes, they are worth 100% of the deceased worker's benefit if collected at full retirement age, but they don't get any bigger. They do not earn delayed-retirement credits. Retirement benefits do. So in this scenario, if the young widow of 60 waits till 66, she can collect the full survivor benefit. She can keep working if she wants, because the earnings cap has disappeared, and her own retirement benefit is going to keep growing by 8% per year. You, as the adviser, have to figure out if that makes sense. Will the widow's own retirement benefit at 70 be worth more than her survivor benefits? In some cases, yes; in some cases, no. That's going to help you determine which benefit to collect first.

OK, this is one of the most popular topics: benefits for divorced spouses. I'll tell you, I go all over the country talking to adviser groups and consumer groups, and women's eyes light up in the audience when I talk about collecting on your ex.

I will say, again, spousal benefits for ex-spouses are gender-neutral. And in fact, the rules are even more beneficial for ex-spouses than they are for currently married couples. The rules are simple. As long as you are marriage lasted at least 10 years, and you are not currently married — that's very important — you may be able to collect on your ex-spouse's work history.

Both you and your spouse have to be at least 62. You have to be age-eligible for Social Security retirement benefits. But this is where ex-spouses have even more flexibility. Your ex-spouse doesn't have to be collecting benefits. He or she just needs to be old enough to collect benefits for you to collect on your ex. But in that case, if you want to collect benefits on your ex-spouse and he or she has not yet claimed benefits, there's an added requirement. That is, you must have been divorced at least two years to exercise the strategy.

But there's an even better strategy for ex-spouses. Just like married couples can coordinate their benefits, a better strategy for an ex-spouse, particularly someone who is continuing to work, is for you to wait until your full retirement age of 66 and then to file a restricted claim for spousal benefits only. You will collect half of your ex-spouse's benefit, and then you can defer collecting your own benefit until 70 and collect that 8% a year of delayed-retirement credits. Now, again, this is where the financial advisers and doing the math for the clients is so important. This strategy might make sense if the divorced spouse will have enough work credits and enough of a benefit that at 70, 132% of her full-retirement-age benefit will in fact be bigger than what she could get as an ex-spouse. The spousal benefit is, remember, half of the worker's benefit.

And ex-spouses can actually collect survivor benefits on their ex-spouse. So let's say your ex-husband has remarried. You were married to him for at least 10 years. You are divorced. You are unmarried. If he dies, his current widow and, yes, you, his ex-wife, both get to claim survivor benefits, which are worth 100% of what he received or was entitled to receive at the time of his death. So that is the ultimate revenge. If there are any divorce attorneys in the audience, or if you know any, I want them to realize that a marriage must last at least 10 years in order for an ex to claim Social Security benefits. I think this should be written into the marriage vows. If you can't make it till death do us part, at least make it a decade.

This is very important. Don't forget the kids. You probably have clients out there who are in those second marriages and may also have second families. A lot of them do not realize that when a parent is collecting a retirement benefit, minor dependent children in the household are also entitled to benefits worth 50% of the parent's primary insurance amount.

Now, this gets to be tricky with the ages of the parent and the kids. Children are entitled to benefits only up until 18, or 19 if they're still in high school. If you are a dad who is maybe 62 and you have, I don't know, a 16-year-old, and you're thinking of retiring early anyway, that might make sense because by the time you are 66, your child would have aged out.

However, if you have young children and you think you're going to have to work a really long time to put them through college, you might want to wait till your full retirement age. And yes, you can file and suspend to trigger benefits for the kids and defer collecting your own until they're worth more later.

A word to the wise: If you do plan to collect early, figuring, “Well, I'll get benefits for the kids,” and you continue to work, remember, if you're younger than full retirement age, you collect Social Security and keep working, your benefits will be reduced if you earn too much. And so will the benefits of the kids. So if you're younger than full retirement age and still working, this may not make sense.

I just want to define what those benefits for dependent minors are. As I said earlier, they must be unmarried children under 18, or under 19 if they're still in high school. Also, children who are disabled before 22 qualify as dependent minors. Each child — if there's more than one — is entitled to 50% of the parent's full-retirement-age benefit. Even if the parent collects a reduced benefit because it's early, the child benefit is still based on half of his full-retirement-age benefit. But there is something called a family maximum. It's generally 150% to 180% of the parent's benefit. It's a very complicated formula.

And finally, I'd like to talk about the do-over strategy. If you have clients who have claimed benefits against your advice and now think better of it, if they change their mind within the first 12 months of claiming retirement benefits, they can actually withdraw their claim for application. They would have to pay back any benefits they had received, including any benefits for a spouse or dependent children, and then start over again later at a higher rate, as if they had never claimed benefits.

It used to be that you could do that for any amount of time, up until 70, but no more. They changed those rules in December 2010. So right now, if you missed that first 12-month window, if you wait till your full retirement age at 66, you can voluntarily suspend your benefits. You can't repay them; you suspend them. You do not receive any benefits during the suspension, but you will earn that 8% per year in delayed-retirement credits up until 70.